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Chair

Mr. James Rajotte

Standing Committee on Finance

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•(0845)

[English]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): I'll ask all of our friends in the media to let us start the meeting, please.

Thank you very much.

Good morning, everyone. This is the 104th meeting of the Standing Committee on Finance. Our orders of the day are, pursuant to Standing Order 108(2), our study at this committee of the report of the Bank of Canada on monetary policy.

We're very pleased to have this morning two witnesses. First we have the Governor of the Bank of Canada, Mr. Mark Carney.

Mr. Carney, welcome back to the finance committee.

We also have the senior deputy governor, Mr. Tiff Macklem.

Mr. Macklem, welcome back to the committee as well.

You have both been here many times before. We look forward to your opening statements, and then we'll have questions from members.

Mr. Carney, I would ask you to begin at this time, please.

Mr. Mark Carney (Governor, Bank of Canada): Thank you very much, Chair, and thanks to the members of the committee for making the time to discuss our January monetary policy report. It's an important time in our economy.

I'll start by saying that while the global economic outlook is slightly weaker than the bank had projected in our October MPR, importantly, global tail risks have diminished.

[Translation]

The economic expansion in the United States is continuing at a gradual pace, restrained by ongoing public and private deleveraging, global weakness and uncertainty related to fiscal negotiations.

Europe remains in recession, with a somewhat more protracted downturn now expected than in October.

Growth in China is improving, though economic activity has slowed further in some other major emerging economies.

Supported by central bank actions and by positive policy developments in Europe, global financial conditions are more stimulative.

[English]

Commodity prices have remained at historically elevated levels, though temporary disruptions and persistent transportation bottlenecks have led to a record discount on Canadian heavy crude.

In Canada the slowdown in the second half of 2012 was more pronounced than the bank had anticipated, owing to weaker business investment and exports. Caution about high debt levels has begun to restrain household spending, but the bank expects economic growth to pick up through this year.

Business investment and exports are projected to rebound as foreign demand strengthens, uncertainty diminishes, and temporary factors that have weighed on resource sector activity are unwound. Nonetheless, exports should remain below their pre-recession peak until the second half of 2014, owing to a lower track for foreign demand and ongoing competitiveness challenges, including the persistent strength of the Canadian dollar. Consumption is expected to grow moderately and residential investment to decline further from historically high levels. The bank expects trend growth in household credit to moderate further, with the debt-to-income ratio stabilizing near current levels.

Relative to the October MPR, Canadian economic activity is expected to be more restrained. Following an estimated 1.9% growth in 2012, the economy is expected to grow by 2% this year and 2.7% in 2014. The bank now expects the Canadian economy to reach full capacity in the second half of 2014, later than we had anticipated in October.

Core inflation has softened by more than the bank had expected, with more muted price pressures across a wide range of goods and services, consistent with the unexpected increase in excess capacity. Total CPI inflation has also been lower than anticipated, reflecting developments in core inflation and weaker than projected gasoline prices. Total CPI inflation is expected to remain around 1% in the near term. It's expected to rise gradually, along with core inflation, to the 2% target in the second half of 2014, as the economy returns to full capacity and inflation expectations remain well anchored.

•(0850)

[Translation]

Despite the reduction in global tail risks as a result of a series of actions by European and American authorities, the inflation outlook in Canada is still subject to significant risks.

The three main upside risks to inflation in Canada relate to the possibility of stronger than expected growth in the U.S. economy, higher Canadian exports and renewed momentum in Canadian residential investment.

The three main downside risks to inflation in Canada relate to the European crisis, more protracted weakness in business investment and exports in Canada, and the possibility that growth in Canadian household spending could be weaker.

Overall, the bank judges that the risks to the inflation outlook in Canada are roughly balanced over the projection period.

[English]

Reflecting all of these factors, the bank maintained the target for the overnight rate at 1%. While some modest withdrawal of monetary policy stimulus will likely be required over time, consistent with achieving the 2% inflation target, the more muted inflation outlook and the beginnings of a more constructive evolution of imbalances in the household sector suggest that the timing of any such withdrawal is less imminent than previously anticipated.

With that, Mr. Chair, Tiff and I would be pleased to take members' questions.

The Chair: Thank you very much, Mr. Carney, for your opening statement.

We will begin colleagues' questions with Ms. Nash.

I'll just remind our colleagues and our witnesses that unfortunately, unlike the U.K., we have severe time limits in Canadian parliamentary committees, so I'll ask you to be as brief as possible in your questions and answers.

Ms. Nash, please.

Ms. Peggy Nash (Parkdale—High Park, NDP): Thank you, Mr. Chair.

Good morning, and welcome again, Governor Carney and Deputy Governor Macklem, to the finance committee.

Governor Carney, I have a question on GDP growth and deficits. Can you tell this committee how much smaller the deficit would have been this year if GDP growth had matched the bank's projections last year?

Mr. Mark Carney: The short answer is that I can't give you a precise estimate of that. There are two elements of the shortfall that are important.

I can give you a written answer using the back-of-the-envelope calculations that are supplied in the budget forecast. The sensitivities, as you are aware, are supplied in the budget when it's released, to both the level of GDP growth and the level of GDP inflation—although I think that CPI inflation is what is actually used.

What's important, as you're aware, is that the shortfall is twofold through 2012. Growth was less than anticipated; we think it's coming in under 2%. Also, GDP inflation was lower as well, so nominal GDP growth was materially less.

The shortfall on GDP inflation is composed of two elements: one —

• (0855)

Ms. Peggy Nash: Excuse me, Governor Carney. I'm really sorry, but I have such little time. Perhaps I'll ask for a follow-up. Maybe we can get—

Mr. Mark Carney: All right. I'll give you a very quick written response on this, which will be at a high level.

Ms. Peggy Nash: That would be great. Thank you.

Given the recent move towards a financial transaction tax by 11 euro zone countries, can you comment on its efficiency and revenue-generating capacity?

Mr. Mark Carney: To be frank, our expectation is that there would be very limited revenue-generating capacity from that tax, unless the tax is truly global, because it's far too easy to move financial transactions to other jurisdictions.

The experience of Sweden is instructive. They tried a similar tax in the nineties, and net revenue actually went down as a result of transactions moving. So that would be our base expectation.

Ms. Peggy Nash: Thank you.

You've spoken out about inequality, and study after study has shown that Canada is becoming a less equal society. Can you comment on some of the negative outcomes that could arise from this situation of growing inequality?

I'm going to ask a second question and we'll see whether there's time for you to answer it. It's about the issue of household debt, which you've also spoken about.

Can you explain what role the introduction of 30-year and 40-year mortgages by this government might have played in exacerbating this debt crisis? And would the levels of household debt exacerbate the harm caused if there were a crash or a serious downturn in housing prices?

Mr. Mark Carney: I'll make these both quick, and it won't do them justice.

One of the most important elements with respect to inequality is intergenerational inequality—to what extent your economic position is predicated on that of your parents. In this regard, it's a question of equality of opportunity, effectively, of how well the society determines it.

I'll point out that there have been a number of studies. Most recently, the Conference Board did a study in this area that highlighted that at least in this very important respect, Canada fares quite well. A variety of policies that are necessary to reinforce this is essential. I won't go into detail on those, given the time.

With respect to household debt, the view of the bank and the view of the government has been that it was desirable to reduce the access to longer-amortization mortgages—30-year or 40-year mortgages—that had been introduced by CMHC and other mortgage insurers. We welcome the steps the government has taken in recent years to do that. It will contribute to a more prudent evolution.

The Chair: You can have a brief question.

Ms. Peggy Nash: Thank you.

Can you elaborate a little bit more? What role could these mortgages, which are still out there, play if there is a serious downturn?

Mr. Mark Carney: With respect to the mortgages that are still out there, the issue is that with a longer-amortization mortgage there's very little amortization obviously in the early years; effectively, a household is just paying interest. The risk is that five years out or even 10 years out, as interest rates normalize, it is beginning a more conventional mortgage anew. In effect there has been no equity built up in the house, unless overall house prices have risen substantially over that period.

That increases the risk to the individual household, since, as you know, mortgages are repriced every five years in this country, even if you have a fixed-rate mortgage.

It has been one of the concerns that low debt servicing costs today, with longer-amortization mortgages, do not necessarily mean low debt servicing costs tomorrow. In fact, they likely imply higher debt servicing costs tomorrow. This is one of the risks in the structure of household debt; you're right.

The Chair: Thank you.

Thank you, Ms. Nash.

We'll go to Ms. McLeod, please.

Mrs. Cathy McLeod (Kamloops—Thompson—Cariboo, CPC): Thank you, Mr. Chair.

Welcome. It's always a pleasure to have you before the finance committee.

I'd like to start by looking at the forecasting that has been done. If you look at the resolution or quasi-resolution of Europe, the fiscal cliff issue in the U.S., or the items we've known for a long time—the bitumen issues and weakening exports—when I look at your forecasts I have to wonder whether it is normal that you have to downgrade your forecast. What have you done over the last number of years? How accurate have your forecasts been in terms of what ultimately is the reality?

• (0900)

Mr. Mark Carney: The quality of forecasting is something we look at. If we look at forecasting relative to consensus and relative to other external observers, such as the IMF, which publishes a forecast for Canada, on average we are slightly better than that consensus since the recession crisis and the recovery. There has been a pretty wide range, though—standard deviation, if you will—around those forecast outcomes.

Let me make a point, though, about the forecast going forward, which is that we have marked down the outlook for the United States and correspondingly the outlook for Canada—there are other reasons for Canada. But importantly, and you touched on some global issues, there have been some very large so-called tail risks in the global economy: the risks around the euro, the risks around the fiscal cliff, which you mentioned. There has been substantial progress in reducing those tail risks.

So even though we now expect the European recession to last longer, Europe is in a better place today than it was in October. Even though U.S. growth has been marked down—and it may actually be lower than we expect, depending on the outcome of the current debt ceiling negotiations in the U.S.—the quality of U.S. growth is better, because what's supporting U.S. growth right now is better-quality activity in the household sector, in the housing market, and the start on corporate investment. So the sustainability of the position is better, and over the medium term this augurs well for Canada.

Mrs. Cathy McLeod: Is the shift from 2.2% to 1.9% a significant shift for the Bank of Canada, compared with other years?

Mr. Mark Carney: Speaking to Ms. Nash's question, it's significant from a fiscal perspective, when coupled with lower GDP inflation. But in terms of the dynamics of Canadian growth, what's important, if one wants to look at the positives—and we should look at the positives sometimes as well as the negatives—is, as I said, that the quality of U.S. growth has picked up. That is important. We haven't fully filtered that in or fully taken it into account in our export forecast for Canada. We have negative judgment, so to speak, in our exports forecast for Canada.

The second thing is that we are starting a rotation of demand that we have expected for some time in Canada. Housing is less important; consumption debt—finance consumption—is less important; and investment and exports ultimately are going to be more important.

Mrs. Cathy McLeod: To follow up in terms of the U.S., they contracted in the fourth quarter of 2012. This was the first contraction seen in the U.S. You talked about the U.S. growing, but how does that align with the contraction?

And of course they're obviously an important trading partner. Are you concerned that the recent GDP contraction in the U.S. is an indication that they're heading for a double-dip recession?

On the other hand, of course, if the U.S. recovery picks up pace, what will that do to the projections? I guess I'm trying to align your comments about the stronger U.S. data with the fact that they actually had a contraction.

Mr. Mark Carney: Yes. Well, there were a few factors that weighed on growth in the U.S. in the fourth quarter, including hurricanes and other one-off factors. Importantly, though, at that time we did expect, and we have seen, the effects of the uncertainty around U.S. fiscal policy weighing on particularly business investment.

We expect to see a pickup in U.S. growth over the course of 2013. The biggest risk, though, given where we are here today, on the fiscal side, is the possibility that sequestration is left untouched in the U.S., which would take about another 0.4 or 0.5 percentage points off U.S. growth this year. That's a fully multiplied number, if you will, from our estimation, and that would be straight off the top of U.S. growth.

That said, we do see a very constructive evolution in the U.S. housing market, in consumer balance sheets and corporate balance sheets, and we see underlying activity in the U.S. picking up over the course of this year. That's our expectation.

• (0905)

The Chair: Thank you, Ms. McLeod.

We'll go to Mr. Brison, please.

Hon. Scott Brison (Kings—Hants, Lib.): Thank you, Chair.

Welcome, Governor, and welcome to the Deputy Governor.

You said just a few minutes ago that you supported or welcomed the tightening of mortgage rules in Canada. Would you agree that loose mortgage rules in the U.S. helped create the housing and personal debt bubble?

Mr. Mark Carney: Without question, the decline in underwriting standards in the U.S., in a variety of forms, contributed to that rise in the housing bubble. I mean, the Americans got to a position on the eve of the crisis where about 15% of mortgages were subprime.

Hon. Scott Brison: Thank you.

It's notable—I'm looking at page 21 of your report—that growth and household debt peaked in 2008. In the first half of 2008, 50% of new mortgages were 40-year mortgages.

You said earlier that you welcomed the steps to tighten the rules. What's your view on the decision to loosen them from 25 to 40 years? You supported the decision to tighten them from 40 years to 25 years. You must have an opinion on the decision to move them from 25 to 40 years back in around 2006.

Mr. Mark Carney: Yes. The expectation at the time of the mortgage insurers was that this would be a niche product and that the underwriting standards would be consistent with a 25-year amortization mortgage. In other words, the individuals who qualified for a 40-year-long amortization mortgage would also have qualified for a 25-year amortization mortgage.

By and large, that second bit has been true. So I would contrast the subprime component of the American market on the eve of their crisis with a very low “subprime” component of the Canadian mortgage stock as it stands—

Hon. Scott Brison: [*Inaudible—Editor*]...half the mortgages issued in 2000 and in the first half.... That's not a niche product, the way it turned out.

Mr. Mark Carney: That was the point I was going to make. But it was not a niche product; it became the norm as a consequence of that.

I think what happened here, quite frankly, is that the long amortization and an expectation of lower interest rates for longer combined for people to forget the fact that mortgages are going to reprice every five years, even if they have a fixed-rate mortgage, and contributed to those...let's say roughly half the mortgages' long amortization, which is why it was necessary for the government to tighten these.

Hon. Scott Brison: Sure, and you expressed support for that decision to tighten, but what about the decision to loosen them in the first place? You must have an opinion on that as well.

Mr. Mark Carney: Hindsight is always 20/20, Mr. Brison.

Hon. Scott Brison: On consumer debt, the bank is expecting personal debt to moderate, yet last month we saw non-mortgage

consumer debt at a record high, I think \$27,000, with total personal debt at \$1.67 for every dollar of income. The trend line isn't going in the direction you're describing.

You, to your credit, have been warning Canadian families about this since 2008-09, but they don't seem to be listening.

Mr. Mark Carney: Well, I actually think they—

Hon. Scott Brison: Why do you think it's going to moderate?

Mr. Mark Carney: I think Canadians are listening, actually, and if you look at the chart you referenced, on page 20, in English, you see the blue line particularly, which is the year-on-year growth of total household debt—mortgages and including consumer and credit card debt—and that has fallen to just over 3% on a year-on-year basis, which is just above the growth of disposable income.

I said in my opening statement that we expect the household debt ratio to stabilize around current levels. It's a reasonable prospect that this year, in the coming quarters, actually, we will see a stabilization of the household debt ratio. Obviously, we're watching this very closely. You're watching this closely. This is one of the reasons why we see a more “constructive” evolution of the imbalances in the household sector and have adjusted our guidance on interest rates.

• (0910)

The Chair: A last brief question, please.

Hon. Scott Brison: Or creative destruction, depending on how you look at it.

You referenced some of the sizable spillover effects of the weakening of the housing sector. How severe could these spillover effects be, and what could be some of those spillover effects for the Canadian economy?

Mr. Mark Carney: Well, the downside risks are several-fold, and it's one of the downside risks we've highlighted for a number of reports for our outlook on inflation.

Chair, I don't know if I have time to give a full answer to this, but they would go to the direct issues around construction. They would go to the use of home equity withdrawal to support consumption. There would be less through the balance sheets of the banks. But I'll stop there, and then if others want to follow up, I can expand.

The Chair: Okay.

Thank you, Mr. Brison.

Mr. Jean, please.

Mr. Brian Jean (Fort McMurray—Athabasca, CPC): Thank you, Mr. Chair.

Thank you very much for coming today, both of you.

First of all, I have to say thank you, Mr. Carney, for all your hard work and for what you've done for the Canadian people and the Canadian economy over the last few years. I wanted to tell you that I've been very impressed with that, and this might be my last opportunity to do so.

I want to talk about two risks to the Canadian economy. I think there's a significant connection and correlation between them. Most of these issues I think are primarily in Alberta, but they affect the whole country.

First, I'd like to talk about labour and the CIBC's December report. It was talking about high-demand positions and how they're going unfilled, and it said that lower-skilled workers continue to be unemployed. I think the saying from the report was "people without jobs and jobs without people". What is that in terms of a threat to the Canadian economy?

Second is pipeline capacity. I've brought this up to you before, but I want to know what you believe at this stage, given what's happening with our crude. In essence, obviously, we have one customer. We ship a lot of oil to the United States. Because of the pipeline capacity constraint, we have, as a result, a discount of 20% to 30% and sometimes even 40% on our oil, compared to Saudi oil, Venezuelan oil, or North Sea crude.

Obviously, that has a significant impact today. I'd like you to talk about how that spread is impacting our economy today and also about how it's going to impact the Canadian economy over the long term. Also, what's the single biggest thing that we, as the federal government, and the provincial governments can do to end this discount in price? What is the threat, what is it costing us, and what can we do as a country to fix it?

Mr. Mark Carney: Those are two very important questions.

First, with respect to, as you rightly say, jobs without people and people without jobs, this is a fundamental issue of a mismatch in the labour market. A number of Canadians are still out of work. I mean, we have had very strong employment growth, G-7-leading employment growth, in this country since the recession. We had a weak employment report, as you know, most recently in January, but if you look back over the course of the year, we've had very strong employment growth and continued growth in hours worked. Our sense in surveys of businesses is that they continue to intend to hire, so it's still a positive outlook for employment as a whole.

That said, in the unemployment rate, we have just under 20% of our unemployed who are long-term unemployed, while only 7%—"only" 7%—relative, I say, to other economies, is still higher than we need. The issue is one of mismatch, and you see it most directly in the skilled trades in Alberta—

Mr. Brian Jean: So that would be about training...?

Mr. Mark Carney: First and foremost, it's about training. It's about accreditation, to some extent, and flexibility across the economy, portability across the economy. We've made advancements there, but this is an issue that's just going to run and run and run and needs constant vigilance and investment.

And it's not just a government issue; it's a business issue as well—

Mr. Brian Jean: The—

Mr. Mark Carney: If I may, there are very important segments of our population, the aboriginal first nations segments, where this is paramount and needs to be attacked by both sides.

Mr. Brian Jean: I want to address your concern, because the \$30 million to \$50 million we're losing per day on our oil discounts is—

Mr. Mark Carney: Yes, I want to come to that, because this is a big issue, and you have raised this in this committee a number of times. We have highlighted it because it's central to the outlook to the Canadian economy.

About a year ago, we had a very odd situation here, unprecedented for a couple of decades, whereby we had a rise in global commodity prices, including oil prices, but it was net negative for the Canadian economy because North Sea oil, or Brent Crude, which is relevant for gas prices in eastern Canada, was up, and gas prices were up. Disposable income was obviously down for Canadians. But the WCS discount was big, and we were losing on the income side.

• (0915)

Mr. Brian Jean: I have only one minute left, so I want to focus on the answer.

Mr. Mark Carney: We have highlighted this issue again in this report, as you would have seen. This is ultimately an issue of pipeline and refining capacity. It is not our view that this is an issue of deficient U.S. demand. We see the possibility of American "energy security" in a few decades, but that's in a North American context that includes a substantial increase in exports of Canadian crude to the U.S. market. Obviously, there is an advantage to having as many options as—

Mr. Brian Jean: As many customers.

Mr. Mark Carney: Yes, as many customers as possible and multiple options from an infrastructure perspective that can be supported by the policy.

Mr. Brian Jean: If I can summarize, what you're suggesting is that the only thing we can do, and the best thing, if we use your 20/20 vision, as you suggested to Mr. Brison, is to concentrate on pipeline capacity and refining capacity. Is that fair to say?

Mr. Mark Carney: This is an infrastructure issue, yes. Those are the two main pieces, yes.

The Chair: Thank you, Mr. Jean.

[Translation]

Mr. Caron, you have the floor.

Mr. Guy Caron (Rimouski-Neigette—Témiscouata—Les Basques, NDP): Thank you, Mr. Chairman.

Welcome, Governor and Senior Deputy Governor.

I am going to ask my three questions all at once and then hopefully you can respond in the same order.

I will begin by saying that I would like to acknowledge the arm's length nature of the governor and the Bank of Canada in terms of monetary policy. However, several questions came to mind when I read your remarks to the finance committee of the British Parliament. I will ask you one of those questions.

You suggested the possibility of using a nominal GDP target rather than an inflation target such as the one we now have. I was a little perplexed by that comment, given the Bank of Canada's current situation. I would like to hear your comments on that and give you an opportunity to give us your perspective.

Furthermore, the Bank of Canada recently noted that Canadian exports have decreased in part because of competitive issues, including the continued strength of the Canadian dollar. Given that the federal government has very little power over the exchange rate, could you tell me if in your opinion multifactor productivity growth should be a priority for the federal government, and if a long-term stable plan for infrastructure investment could be a way of counteracting that weakness in productivity?

Last, the vice-chair of the United States Federal Reserve, the FED, gave a presentation yesterday and said the following. I will read the quote in English.

[English]

"Both for the United States and for Europe...fiscal austerity does raise unemployment, weaken the economy and...in addition undermines the goals it is designed to achieve"....

[Translation]

The direction that the Canadian government has taken has focused on austerity even though the extent differs from that of the United States. I would like to hear your comments on the statement made by the vice-chair of the FED and what its implications could be from a Canadian perspective.

Mr. Mark Carney: Thank you very much.

Mr. Chairman, how much time do I have to answer those questions?

[English]

The Chair: You have about three minutes.

[Translation]

Mr. Mark Carney: Good.

In terms of inflation control, it is still the Bank of Canada's position that a flexible framework for inflation targets is the best. Here in Canada, we are in a very different position from that of the United Kingdom. We do not have significant public and private deleveraging. We do not have a zero floor. The financial sector is not experiencing the same problems that they have. As I stated last week, I support a flexible framework for inflation targets in Canada and in the United Kingdom. One of Canada's great advantages is that every five years, the Government of Canada, the Bank of Canada and this committee undertake an analysis of the situation. That is an opportunity to strengthen or modify the framework. It is under that process that we can review the framework.

● (0920)

[English]

I'm going to switch to English to be quick.

On the weakness of exports, yes, it's an issue of competitiveness, and it's related in part to the persistent strength of the dollar. Two-thirds of that loss of competitiveness over the last decade or a little more has been because of the strength of the dollar. We haven't grown productivity to make up for that. We are in a situation in which there are a variety of factors and in which our dollar has moved from being undervalued to being persistently strong in our terminology. It's not clear whether those factors are going to move away.

Canada is a bit of a safe haven. There's lots of desire for investment here, and we're in a relatively strong position. That being said, the Minister of Finance and I released a statement this morning on behalf of the G-7, which reaffirmed the commitment of the G-7 to ensure that monetary policy is focused on domestic objectives, not on targeting exchange rates. We hold the members of the G-7 to that long-standing position. This is extremely important. It's important that we, as the G-7, go into the G-20 united and forceful to enlarge that commitment as quickly as possible amongst the major emerging economies in the G-20, some of which entirely ascribe to flexible exchange rates and are supportive, and others of which have a lot of work to do in this regard, because, in part, of the dysfunctionality of the international monetary system.

Lastly, on fiscal policy, the position of the U.S. and Europe is very different from that of Canada. The U.S. has the benefit of having the reserved currency. It is at the zero lower bound. Fiscal policy is much more expansionary at the zero lower bound. Europe is not in a position to have the flexibility of the U.S. In Canada, I think, as well, despite all our safe-haven attributes, it's important that we reinforce it. I'll leave it to the elected officials to decide how quickly, but we're not the United States, and we don't have the flexibility that they enjoy.

The Chair: We'll go to Mr. Adler, please.

Mr. Mark Adler (York Centre, CPC): Thank you, Mr. Chair.

I want to begin, Mr. Carney, by thanking you for your service to Canada. Canadians are indebted to you. We're certainly going to miss you.

I just want to pursue a line of questioning that you had broached in your previous answer to Monsieur Caron. I want to talk a bit about the burgeoning currency weakness, i.e., the currency war. Some have said, given the appreciation of the Canadian dollar over the last number of years, that we should be pushing the dollar back and undervaluing the currency. That would be their solution to having a Canadian industrial policy. The French foreign minister, as you know, just said recently that the rising euro will have a negative effect on European growth.

Could you talk a bit about how managing exchange rates as an alternative to monetary policy would negatively impact the Canadian economy and what effect that would have on the global economy, or in reverse?

Mr. Mark Carney: Yes. This is an important point, and it goes to Monsieur Caron's question on our monetary policy framework.

We have a commitment to flexible inflation targeting, as you know, and an important component of that is a flexible exchange rate. I can link a few of the questions we have here—i.e., why do we have a flexible exchange rate? We have one of the longest histories in the advanced world with flexible exchange rates. In effect, it acts as a shock absorber, as there are shocks both domestically or internationally—shocks potentially, for example, to commodity prices that we see.

The basic point we make and that we've observed, and are observing elsewhere, is that the economy needs to adjust to these shocks. The exchange rate helps with that adjustment. If we were to persistently intervene and try to control the exchange rate, there's a variety of challenges with that. But even if we were successful, there's a variety of operational challenges with actually being successful in, say, holding the exchange rate down.

But even if we were successful, the economy would adjust anyway, and we would see the adjustment more broadly in the case of wages, for example. So if we had a fundamental competitiveness problem, and we were forcing the adjustment through falling wages in Canada, that is a much more difficult adjustment than to have an adjustment in the exchange rate that would flow naturally.

This is—and I hate to say it, but it's true—part of the challenge that a number of members of the euro zone are experiencing right now. In order to restore competitiveness, in effect they have to have deflation on wages, and that is extremely difficult and socially destructive.

• (0925)

Mr. Mark Adler: We have a very aggressive trade agenda. What effect would that have on negotiating future trade agreements and on trade in general?

Mr. Mark Carney: Do you mean if we were to target the exchange rate?

Mr. Mark Adler: Yes.

Mr. Mark Carney: The expectation, I'm certain, in all of the discussions is that Canada is a free-trading nation and supports free movement of capital as well. If we were to try to control the level of our exchange rate, we would have to take a variety of steps and start to close what is one of the most open and effective, we would argue, capital markets and money markets in the world in order to be successful.

Then a series of regulations that would come into place and restrictions that would come into place there would be inconsistent with the overall move towards free markets. That's number one. Secondly, there would undoubtedly be a suspicion that we weren't trying to move the exchange rate to an equilibrium level but were trying to gain a competitive advantage by moving the exchange rate below an "equilibrium level".

The exchange rate will find its equilibrium over time. There can be periods where it's persistently strong. That does take some adjustment. We are in a position right now in Canada where we know that we're not as productive as we could be and need to be. We

know that we have to diversify our trade, as the trade agenda suggests.

Our suggestion is that we focus on the things we can control, which is the trade agenda, making the country more productive, as Monsieur Caron suggested. In that regard, a strong exchange rate is to our advantage, because we import most of our machinery, equipment, and ICT.

The Chair: You have time for one last very quick question.

Mr. Mark Adler: I'm okay. My question would take too long.

The Chair: Okay. Thank you, Mr. Adler.

[*Translation*]

Mr. Côté, you have the floor.

Mr. Raymond Côté (Beauport—Limoilou, NDP): Thank you very much, Mr. Chair.

Governor, Senior Deputy Governor, thank you for coming today.

I am going to move away from the big economic issues now and bring you into my beautiful riding of Beauport—Limoilou. Last October, I organized, along with my colleagues in the Quebec City region, a forum on credit card costs. As you know, for about five or six years now, there has been an unbelievable explosion of credit cards and other types of cards, such as reward cards. It is a problem that is hitting retailers generally at various levels. Even Walmart reacted to this in the United States.

Let's talk about the Canadian situation. Let's be frank, our retailers' hands are tied. For any one credit card company, they do not have a choice. If they want to provide Visa transactions, for example, then they have to accept all cards under that brand. Our retailers are telling us that this is a very serious problem. It is very hard for them to do any forecasting for the purposes of making a reasonable profit.

Do you think that this is a major problem? Do you think that this is an actual transfer of wealth from small retailers and the public in general to a financial sector that is less tied to the economy?

Mr. Mark Carney: Mr. Macklem will respond to that.

Mr. Tiff Macklem (Senior Deputy Governor, Bank of Canada): Thank you.

There are all kinds of innovations, and significant competition in the credit card sector. There are good innovations and not-so-good innovations. We have seen that in the financial sector over the past few years.

It is not the Bank of Canada's mandate to regulate credit cards. The Minister of Finance established a code of conduct for credit cards in an attempt to deal with the kind of problem you have raised.

The Bank of Canada is more concerned about the significant increase in household debt. As Mr. Brison pointed out, even though the rate of increase in household debt has slowed down, the level of household debt is still high. There are currently positive developments in household imbalances but it is too soon to let down our guard.

• (0930)

Mr. Raymond Côté: Nonetheless, there has been an erosion of purchasing power. We could talk about transaction fees set by banks who do not even wait for one year to end before modifying the fees exacted from clients. That represents a considerable amount on a national scale. It ends up reducing individuals' purchasing power. This phenomenon is therefore problematic for the domestic market.

Mr. Tiff Macklem: I don't think that it is up to us to defend the private banks. They have their policies and I would encourage households to find the best options for their situation.

Mr. Mark Carney: I would just like to add that the situation is more serious in places like Australia and other countries. That also means that we should be acting here.

As Mr. Macklem pointed out, the Minister of Finance established that code of conduct. It should be implemented.

Mr. Raymond Côté: The code of conduct is simply a statement of intent.

Mr. Mark Carney: Yes, but it also implies that the responsibility lies with

[English]

FCAC, the Financial Consumer Agency of Canada.

[Translation]

It is the Financial Consumer Agency of Canada's responsibility to monitor the situation.

Mr. Raymond Côté: My understanding of this is that there is a transfer of wealth to high end credit card holders.

Mr. Mark Carney: We understand the situation. It is an important one. This is an issue that concerns consumers. The government has a plan. It is an important issue for individuals, but it is not necessarily an important issue in terms of Canada's economic outlook.

[English]

The Chair: Merci.

Mr. Van Kesteren, go ahead, please.

Mr. Dave Van Kesteren (Chatham-Kent—Essex, CPC): Thank you, Chair.

Thank you, Governor and Deputy Governor, for appearing.

Likewise I'd like to congratulate you on your recent appointment. Although we're very happy for you, we're going to miss you too. It's been a great experience having you head that. Whoever fills those shoes will do a great job as well.

There has been a lot of talk about the Dutch disease—and we need to clear the good name of the Dutch maybe—and the allegation that the high oil prices have caused manufacturing to leave. You made some pretty emphatic quotes during the summer. I will quote you, if I can. You said "It's too simple. The factors influencing our currency are more complex than one price or another, one interest rate or another. There are several factors and our economy is much more integrated than that." You concluded by saying, "I reject that argument completely."

I wonder if you could explain to the Canadian public, once and for all, why you feel that is incorrect.

Mr. Mark Carney: I'm happy to clear the good name of the Dutch. We'll speak in terms of the importance of commodities and commodity prices for the Canadian economy.

Let me start by underscoring that at the Bank of Canada we use, for forecasting purposes, 20-plus models, but our core general equilibrium model is called ToTEM. It's a terms-of-trade model. We run a terms-of-trade model because of the importance of the prices we receive for our exports—of which an important component is commodities—and the prices we pay for imports. This is at the heart of how we forecast and how we look at the Canadian economy, because the multiplier effects are that large. That's the first point.

The second is that when we look at past experience, only in rare exceptions—and I mentioned one in response to Mr. Jean's question—does an increase in commodity prices not benefit the Canadian economy.

One of the things that is drawn out in our analysis, which I referred to in a speech I gave in the summer, is that one of the challenges we have in the Canadian economy now is that historically what drove commodity prices was U.S. demand. That was the most important thing. So you'd have higher U.S. demand, higher commodity prices, but also obviously higher U.S. demand for the other goods that are produced by the Canadian economy, manufacturing goods. That was very positive for Canada and it remains very positive for Canada.

But the U.S. is not pricing commodities these days. If you had to pick a region, you'd say Asia is pricing commodities. Our economy is less oriented to Asia. So an increase in commodity prices, to put rough figures on it, that's driven by the U.S. is about three times as positive for Canada as one driven by Asia, but an increase in commodity prices driven by Asia is still materially positive for the Canadian economy, despite the fact that it also encourages, all things being equal, a rise in our exchange rate. The reason for this is the income effects on those commodity producers, because of the direct investment effects—which are driven not just in the oil patch but in mining, forestry, and other areas—and because of the revenue effects to all levels of government, including, very importantly, the federal government.

The federal government takes about 40% of the revenues, as you know, Brian, on an all-in basis from your riding, or, more broadly, from the oil sands, and then, importantly, because of the linkages through this economy—which are much stronger east-west than they are north-south—into the manufacturing parts of our economy and the services parts of our economy, which are linked into the commodity sectors.

I will make two other points, if I may, Chair. One is that we don't see commodity prices being elevated as a temporary phenomenon. They go up; they go down. We have this discount issue on WCS western crude. But we see the transformation of the global economy that is taking place. There is commodity-intensive growth being driven by an emerging Asia, which is supporting commodity prices as a whole. This is core to the old "Dutch disease" thesis: you had a temporary spike in a commodity, and then it came down and you shifted resources. We see this as more permanent.

The last point is that, as per other questions, there are a variety of factors that drive our currency. There are the terms of trade, but also our better fiscal position, our monetary policy credibility—we're a safe haven—the strength of our banking sector, and, it has to be said, the fact that there has been in recent years an understandable generalized weakness in the U.S. dollar and a diversification of currencies internationally out of the U.S. dollar and out of the euro. There are relatively few other places to go. So a variety of these factors are supporting our currency.

We see the need to respond to those realities and drive not just monetary policy—though ultimately we care about the outlook for growth and inflation in Canada—but a broader suite of policies that reflect those dynamics.

• (0935)

The Chair: Thank you.

Thank you, Mr. Van Kesteren.

Mr. Rankin, go ahead, please.

Mr. Murray Rankin (Victoria, NDP): Thank you, Chair.

Good morning, and thank you very much, Governor and Mr. Macklem.

I'm going to shift gears and ask a couple of questions, if I may, on governance arrangements at the bank. I've noticed there's some confusion in the media, as there is amongst some of us members of Parliament, about which codes of conduct and guidelines apply to the Governor of the Bank. Given the importance of the office of the governor, and of course given the key need for independence, I think it would be valuable if, for the record, you might clarify which codes of conduct and guidelines apply to the person who serves as governor, given that the incumbent is concurrently Canada's ultimate governor to the International Monetary Fund. For example, I'm advised it is the bank's formal position that the bank's guidelines specifically apply to you and to the board. Is that correct?

Mr. Mark Carney: Sorry. The first question was whether the Bank of Canada's guidelines apply to the governor and the senior deputy governor. The answer is yes.

• (0940)

Mr. Murray Rankin: Given that the governor serves as the alternate governor to the International Monetary Fund, wouldn't the PCO guidelines likewise apply?

Mr. Mark Carney: To the governor in the capacity as the alternate governor to the IMF, those guidelines would apply.

Mr. Murray Rankin: Likewise, do lobbyist registration rules apply to the Governor of the Bank?

Mr. Mark Carney: The lobbyist registration rules do not apply to the governor.

Mr. Murray Rankin: All right.

It's my understanding that under the present arrangement it's the bank's general counsel who is both author of the bank's conflict of interest guidelines and the person called upon to interpret them in specific cases. If that's so, do you think that process is sufficient, or does it need strengthening, in your view?

Mr. Mark Carney: The bank's code of conduct is approved by the bank's independent board of directors. The determinations of conduct consistent with the code, or if there are issues consistent with the bank's code related to the governor or the senior deputy governor, are conducted by the general counsel, who is secretary to the board, in conjunction with the independent directors of the board, obviously not including the governor and the senior deputy governor, who are recused for obvious reasons.

Mr. Murray Rankin: I'd like to ask you another question concerning temporary foreign workers. We've heard in the news about recent policy decisions to allow temporary foreign workers to be paid, I believe, 15% below market wage for their services.

If my understanding of economics is correct—and it may not be—it seems this will tend to put downward pressure on wages in the relevant sector, which would discourage workers from obtaining relevant training. Is your analysis similar to that?

Mr. Mark Carney: The issue would have to be—as I believe it is, but I stand to be corrected—that in order to have temporary foreign workers there has to be a demonstration that there are not Canadian residents who are able to do the work. The timeline for filling the position should be such that if there is going to be training to then fill the position with a Canadian resident worker who wants to fill the position, the two must dovetail.

In other words, it's truly a temporary arrangement as opposed to a rolling temporary arrangement, which becomes a permanent arrangement. So the spirit of it should be that they're temporary, and if Canadians need to be trained, they have the opportunity to be trained, and then that discount would be removed.

Mr. Murray Rankin: But that's solely on that premise; that is, if they are truly temporary in nature. If they're continuing on a long-term—

Mr. Mark Carney: For the economics to work, that premise should hold.

Mr. Murray Rankin: All right. Thank you.

The Chair: Thank you.

We'll go to Mr. Hoback.

Mr. Tiff Macklem: I would maybe just add one thing a little more broadly on this issue of foreign workers.

The Chair: Sorry, Mr. Macklem.

Mr. Tiff Macklem: Getting back to Mr. Jean's question, in the recession there were a lot of people out of work and it was really about finding jobs for people. As you look into the future, with declining labour force growth and with baby boomers who are retiring, increasingly the challenge is going to be finding workers for jobs.

We've talked about some of the ways to address that. It could be drawing underserved parts of the labour force into the labour force. It could be making the labour force more efficient. But another element of that is immigration and effective immigration policies.

We don't look at specific things like temporary foreign worker programs, but it is a broader issue that deserves some attention.

The Chair: Thank you.

Thank you, Mr. Rankin.

Mr. Hoback, go ahead, please.

Mr. Randy Hoback (Prince Albert, CPC): Thank you, Chair.

I, too, want to wish you and your family all the best as you move on to your next adventure. You seem to like to slay dragons, so I think you're going to have some interesting dragons in Europe while you're over there. But we wish you all the best and all the success, because if you have success over there, then we have success back here in Canada, and that's very important. So I want to wish you all the best, for sure.

This past year, in a recent speech, Deputy Governor Macklem, you made some interesting comments about Canada's exports and trading interests. You talked about our overreliance on the U.S. and the problems that has created in the past. You also talked about the underperformance, and who we trade with, and basically about how we should be engaging with the emerging markets, and about how Canadian companies are maybe a little too slow to get involved in these emerging markets.

With that reality in mind, just how critical is it for Canada to pursue more trade diversification through free trade agreements with India or CETA, and to participate in forums like the Trans-Pacific Partnership? I feel trade is very critical, and I am just looking for your opinion on how important trade is.

• (0945)

Mr. Tiff Macklem: To retrace a little bit what I said in that speech, and indeed what we've both been talking about on a number of occasions...being right beside the United States, historically, has been a wonderful thing. It has been one of the biggest and growing markets in the world. But the reality is that while the U.S. is still the biggest economy in the world, it's in a grinding, deleveraging recovery, and that's going to go on for some time. We are seeing recovery in the United States, and the governor highlighted a number of positive signals, but they still have a big fiscal adjustment, and it's going to be a modest recovery.

What that means for our businesses is that it's going to be more about fighting about share of the U.S. market than it will be about being part of a rapidly growing market. Where our exporters need to devote more attention in developing markets is in those rapidly growing markets, where all boats can rise with the rising tide. That speaks importantly to Asia and to parts of Latin America.

Then, getting to trade, clearly trade is a big part of that. Traditionally, Canada has been a big proponent of multilateral trade. Unfortunately, the multilateral trade negotiations have ground to a complete halt, so the government very appropriately is moving aggressively to develop, both with individual countries and various regional programs particularly focused on emerging markets, the

Trans-Pacific Partnership that you mentioned, and there are engagements with China and with India. These will take some time, but these are certainly positive steps.

We talk a lot about developing those foreign markets. We talk a lot about how we're going to raise productivity. These are essential elements in that future.

Mr. Randy Hoback: I guess when you look at it...you also made a comment about Canadian businesses not grabbing or seizing the opportunities that exist in those areas. Is there any advice you have for highlighting or making people understand the importance of our businesses going abroad and actually grabbing or seizing those opportunities? Do you have any advice on how to get that to happen?

Mr. Tiff Macklem: There are a few things. I think it starts with really recognizing that just waiting for the U.S. to come roaring back is not a great strategy. You're going to have to get out there more aggressively. We recognize that historically it's been very easy to do business with the United States. It's right next door to us, we watch the same TV shows—we have a lot in common. It does take some extra effort, particularly for small or medium-sized businesses, but we have very good trade councils. I would certainly take full advantage of those as a way to get in.

The other thing to recognize is that the nature of trade is changing. It's not as much about producing stuff for export in a sector. Increasingly, it's about being part of a global supply chain, about having an affiliate in another country, using Canadian management, Canadian design, and Canadian expertise. The nature of trade relationships is changing, and Canadian businesses need to recognize and adapt to that.

Mr. Randy Hoback: That's a very good point. Bombardier is a good example, with what they do in Mexico, the United States, and Canada, and how they use their expertise in Montreal and—

Mr. Tiff Macklem: It links to our commodity sector. There is a lot of technology, there is a lot of expertise, and there is a lot of design in commodities. It's something that we can leverage globally. There are a lot of commodities to be developed around the world.

Mr. Randy Hoback: Thank you, Chair.

The Chair: Thank you, Mr. Hoback.

We'll go to Ms. Glover, please.

• (0950)

Mrs. Shelly Glover (Saint Boniface, CPC): Thank you, Mr. Chair.

I also want to offer my sincere thanks to you, Governor Carney. It's been a pleasure dealing with you here in the finance committee, and I wish you all of the success possible in the United Kingdom.

I'm going to ask you about jobs. The last time you were here you commented about jobs. There are some who are implying that we haven't recovered all of the jobs since the recession. There are some who are implying that we haven't recovered quality jobs.

I'm going to ask you very specifically: have we recovered the jobs we lost in the recession? If so, what is the level of quality of those jobs? Are they full-time? Are they part-time? Are they in the private sector? Are they in the public sector? Please fill us in.

Mr. Mark Carney: Something tells me you know the answers to these questions—

Voices: Oh, oh!

Mr. Mark Carney: —but I will give you the objective view.

Canada has recovered all the jobs lost in the recession, and more. A little more than double the jobs—the just under 300,000 jobs lost in the recession—we have recovered.... Well, actually, it's maybe 400,000.

Mr. Tiff Macklem: Yes, there were a little over 400,000 lost. We've regained all of those—

Mr. Mark Carney: We've regained all back—

Mr. Tiff Macklem: —and doubled.

Mr. Mark Carney: —and then doubled, again.

The second point is that about 70% of those have been in the private sector. It moves around with each employment report, obviously, but the vast majority, again, north of 70% or 80%, have been full-time.

Actually, I should say it's higher than that; I understated: 70% of those have been in industries that pay above-average wage. So again, from a quality-of-job perspective, it's high. Most of them, the vast majority, are in the private sector, and the vast majority are full-time.

So it has been positive. The other thing that has been positive about the performance is that by and large the participation ratio in the job market has remained high, just under 67%. In other words, Canadians are out there looking for work. They're not discouraged.

Now, from a monetary policy perspective, if I may add on what we look at as well, we do still see slack in the labour market. The unemployment rate is 7%, so it's come down, but it's still higher than we would see consistent with full employment. Just under 20% of the unemployed have been unemployed for more than six months, so they are looking for work. There are some of these mismatch issues that exist as well. And hours worked have not recovered as firmly as employment. I mean, it's good news that we've got more people into work, but people aren't working as many hours as necessarily they would want to or as employers would see in full employment.

From an inflation perspective, from a monetary policy perspective, we do see slack—it's an odd word to use, but it is slack—in the labour market, which is consistent with the maintenance of very accommodative monetary policy for some time.

Mrs. Shelly Glover: How do we compare with our G-7 counterparts in job growth?

Mr. Mark Carney: The performance is superior to....

In fact, since I already have to furnish a written answer anyway, to the first question of the day, we can furnish some charts that show the path of employment growth in the G-7. Canada is at the top.

Just as a number....

Mr. Tiff Macklem: I can give a couple of quick numbers, if you want.

Through the recession, Canada lost, on a proportionate basis, half as many jobs as the United States. We're more than 200% above where we were at the trough. The United States is less than 60%. So they haven't even regained all their jobs. They're only about 60%, or a little less, off the trough.

Mr. Mark Carney: It's really only Germany that approaches the Canadian performance.

Mr. Tiff Macklem: Yes, it's really only Germany.

Mrs. Shelly Glover: Very good. But we're at the top—which is a nice place to be.

I was very glad, Governor, that you corrected some, I guess, misleading comments about who actually raised mortgage rates. I mean, you were in Finance in 2006, and it was actually the mortgage insurers, not the government, who raised them. The government took measures to relieve them.

I want you to comment on how those measures, such as reducing the amortization period to 25 years for government-insured mortgages and increasing the oversight of CMHC, helped address the concerns surrounding the housing market. How did this help to slow household credit growth?

Mr. Mark Carney: Well, I think the short answer is that both have helped. There have been four tightenings of mortgage insurance rules, which have been shortening amortization, raising qualifying interest rates, raising the minimum down payment, ending the ability to get mortgage insurance for a second home, and ending the ability to have mortgage insurance on a refinancing. Effectively all of those tightenings have been sensible. They've been paced so they didn't all come in at once and cause a sharp adjustment to the Canadian housing market. In our view, they've been timely and prudent. The oversight arrangements are welcome, and the continued quality of mortgage underwriting is absolutely essential to the long-term health of the market, and obviously to the fiscal position of the country as well, because ultimately there is a government backstop here.

The other thing I would highlight, which has been positive for the evolution of the market, is OSFI's introduction to mortgage underwriting guidelines and the tightening effect of those mortgage underwriting guidelines that came in last summer. That's been particularly relevant for home equity loans, or so-called HELOCs, and personal lines of credit, for which the underwriting standards were beginning to slip. OSFI acted in a timely way.

All of that has helped constructive evolution. If I may bring it back to monetary policy, we do see those measures, and we think that on the margin, the bank's tightening bias has reinforced or supported those measures, resulting in a slowdown in the pace of household growth and the start of a rotation of activity away from the housing sector to other sectors of the economy—and business investment is an important example. That should help contribute to a sustainable evolution of our growth. It also means that the prospect of tightening monetary policy is less imminent than we previously had anticipated .

• (0955)

The Chair: Okay, thank you.

Thank you, Ms. Glover.

Ms. Nash, go ahead, please.

Ms. Peggy Nash: Thank you, Mr. Chair.

Governor, given your comments about the importance of financial literacy, do you think the work of the Parliamentary Budget Officer is important?

Mr. Mark Carney: I think parliamentarians and Canadians, as the ultimate consumers of that information, are as good at judging as we are at the Bank of Canada are the value of an independent assessment of the fiscal position and elements of the fiscal position.

Ms. Peggy Nash: Thank you.

I was reading with interest the January "Monetary Policy Report" from the Bank of Canada. It noted that wage growth has slowed.

You mentioned here today the persistent slack in the labour market, the high levels of involuntary part-time work, the duration of unemployment, and the ongoing relatively low average number of hours worked. I noticed, with regard to the duration, that the proportion of long-term unemployed is particularly stark, climbing last year to 19.2% of the ranks of the jobless from 13.2% in 2007. CIBC has said that "easing long-term unemployment is essential 'to underpin consumer spending, household health indicators and support of broader economic recovery'". Do you agree with that assessment?

Mr. Mark Carney: I would agree with the assessment. One of the issues is that the longer individuals are unemployed, the more their skills atrophy; they lose workplace attachment, and it's a self-reinforcing process. I will give you one figure. We have to work on the issues in Canada, so it's not just about being better than the U.S. But to give a sense of the depth of the U.S. recession and the weakness of the recovery, the analogous figure in the U.S. is over 40% long-term unemployed. This is a real issue. To give you an insight in terms of the strength of federal monetary policy, it is in part conditioned on the danger that the 40% long-term unemployed

in the U.S. will become, effectively, permanently unemployable, to put it in its starkest terms.

Ms. Peggy Nash: Right. So we're not as bad as the other guys, but it's a problem we need to take seriously. Of course if they don't resolve it in the U.S., it could become a problem for Canada.

Mr. Mark Carney: It's one of the issues, which means there is a weaker demand from the U.S., all things being equal, than there would be otherwise. In Canada it is one of the aspects of the slack in the labour market. It is still considerable. It is consistent with a substantial monetary policy stimulus. It's one of the reasons interest rates are 1%, even though our financial sector is firing on all cylinders. We have other issues with household debt and other things that you're well aware of.

• (1000)

Ms. Peggy Nash: For my last question, you mentioned earlier that you didn't think the financial transaction tax had worked in Sweden, so I wonder why 11 countries in Europe have brought this in. I know that the IMF has talked about perhaps a financial activity tax, given that there's no value-added tax on financial transactions. Is that something you would favour? Given the actual economic and fiscal moment that we're in—you've spoken about "dead money" in Canada, more than half a trillion with corporations—what are the best methods for revenue generation for governments today? That's an easy one.

Voices: Oh, oh!

Mr. Mark Carney: That's an easy one, yes.

The interesting proposal by the IMF a few years ago.... I'll get my acronyms wrong; it might have been the so-called fat taxes, as you were referencing. But related to taxes on wholesale borrowing by banks, it was to reduce the incentive for banks to borrow in the capital markets, because that borrowing creates a risk to the system as a whole. It creates a negative externality. It makes them too big to fail and it causes the types of crises that we saw. The issue was, well, could you use tax policy to reduce that?

What the regulatory community has done is to use regulation instead of tax policy to do it, in part because of the arbitrage issues I talked about earlier, which suggests...and part of that judgment was based on the ability to evade a tax by changing an instrument slightly or borrowing in a different subsidiary, etc., not having a global approach. I wouldn't recommend it as a good revenue generator.

Am I out of time to answer? Because I was so close to answering what is most efficient....

The Chair: Well, we are over time, unfortunately.

I'll talk to you during my round, so perhaps I'll give you 20 seconds to answer that question first, Governor Carney.

Mr. Mark Carney: Whoa.... Well, thank you, Chair.

Voices: Oh, oh!

Mr. Mark Carney: In general—in general—analysis of relative efficiency of tax from a revenue perspective, from a non-distorting of economic activity perspective.... In general, value-added taxes are the most efficient mechanism. There are issues.... As with all tax policy, though, one has to worry about distributional consequences, regressivity, if you will—that's a word—and other political economy factors. But if you're just looking at efficiency of raising revenue and not distorting economic activity in general, the value-added tax, set at a relatively low level, would be the most efficient mechanism.

The Chair: Okay. Thank you for that.

Governor Carney, I want to move next to one of your written responses to the Treasury Select Committee. You talked about the Bank of England having to “enhance its forecasting”, and you've had questions on forecasting for the Bank of Canada from both sides of the table today. Is that a fair point to make about the Bank of Canada as well with respect to forecasts?

Mr. Mark Carney: Yes. Thank you for the question. It's an important one.

One of the things we've been doing...and I hesitate to suggest things to my successor and successors on the governing council, but periodic review of forecasting, and public discussion, debate, whether at this committee or in other avenues, of how the bank forecasts and how we could improve would be welcome and make sense.

One of the things we have done, though, just to be clear, over the course of the last year or couple of years, is that we have done a detailed analysis and are now putting in place a series of so-called nowcasting tools, tools, in other words, to forecast ahead a quarter or a couple of quarters. We're just starting to put these in place now, using a variety of sophisticated statistical techniques. We always have to overlay judgment on that. You'll see the product of that.

The second point, if I may.... I don't know how much time you can give me.

The Chair: And that will be out when?

Mr. Mark Carney: Okay, but very quickly, the second point is that what we've tried to do as well, and we can continue to improve this, is to make clear.... One of the key things is, what are the key assumptions in the forecast and what drives the forecast? What I would like to leave this committee with, what we would like to leave the committee with, is a clear point...I think it's graph 19, which shows very clearly the contribution from business investment and net exports: the negative contribution over the course of the last few quarters, and the very large positive contribution, the flip, that we see over the next two years.

What matters, really, for our forecast is that we're going to have to see a pickup in business investment, and we'll have to start seeing some penetration on those export markets. If we don't get that, for whatever reason, our forecast is going to be too high, so we need to do as good a job as highlighting the key elements of the forecast to this committee and to Canadians, so people can make their own judgments.

•(1005)

The Chair: With respect to that, and with respect to business investment, you were portrayed in the past as being slightly critical

of a lot of businesses in Canada for not spending enough on investments. Do you stand by those statements, or would you say that in fact you've seen some activity in recent months that has addressed some of your concerns with respect to spending by Canadian businesses in Canada?

Mr. Mark Carney: We absolutely stand by the statements. Mr. Macklem, in effect, repeated them in his recent speech, which Mr. Hoback referenced.

There is a chart that looks at Canadian business investment relative to history. We're about average. It's solid. It's not spectacular. It's a little below average. But we're not in average circumstances. We have a big productivity deficit. We need to reorient to new markets. We have a very strong currency.

Investment disappointed in the second half of last year. Now, we think there are some special factors, and particularly around some engineering works and some issues in offshore Newfoundland and in Alberta as well. That will come back. Part of this is uncertainty, given the U.S. and European situations. That's dissipating a bit. The sum of those is one of the reasons we expect things to pick up. If we are here in April—and I hope we are going to be with our next MPR—I think we should be able to point to some signs of a return to solid business investment growth by that point.

The Chair: Okay.

My time is up for this round. I'm going to go quickly to Mr. Brison, and then I'll come back with a few more questions.

Mr. Brison, at this point, go ahead quickly.

Hon. Scott Brison: Thank you very much.

I have a couple of follow-up questions to Ms. Glover's questions, actually.

One is on oversight of CMHC. Which ministers are responsible for CMHC oversight?

Mr. Mark Carney: It's really a question for the government, but I know the answer. Historically, the responsible minister was the Minister for HRSDC, Human Resources and Skills Development. I believe—and I'll be corrected by members of this committee—that now there's a joint responsibility with the Minister of Finance, which, I believe, reflects one of the governance reforms introduced in the last budget.

Hon. Scott Brison: Also as a follow-up to one of Ms. Glover's questions, let's talk about the employment rate—not the unemployment rate, but the ratio of those who are employed to the working-age population. How are we doing in terms of our employment rate compared to what it was before the recession?

Mr. Mark Carney: Our employment rate is about 62%. As for what it was pre-recession, I don't have that figure at hand. It would be lower than it was pre-recession, because the labour force has continued to grow. I think we're off—and I'll add this to our written submission—just under two percentage points, so it would have been about 64% before, and we're now around 62%. I recall from the U.S. that the fall in the employment rate is about five or six percentage points. The adjustment is quite dramatic. We've highlighted this in previous reports.

So we're seeing that. Some of that is the demographic: as individuals come into their fifties they're less employed. You're fully employed and you're 50, but they're less employed.

Some hon. members: Oh, oh!

Mr. Mark Carney: Anyway, we'll get you the figure. That's another aspect of there being some slack in the—

Hon. Scott Brison: So we haven't recovered to pre-recession levels in terms of employment rate.

Mr. Mark Carney: We haven't recovered, but I caution you there a bit. The recession coincided with the start of the demographic adjustment, which, as this committee would know, is actually pretty severe over the course of the next decade. So you do get into those higher-age cohorts—the fifties—where there is just a lower employment rate, even though it has held up better than previous—

Hon. Scott Brison: But job creation has not kept up with the pace of the working-age population?

Mr. Mark Carney: Yes, we have slack in the labour market. The unemployment rate is higher than it was before. But, again, I think the spirit of the question was about how we have done relative to others, given the shock to demand that's happened globally, and it is quite distinct.

•(1010)

Hon. Scott Brison: This is just Ms. Glover and I working closer together to ensure that Canadians hear all of the truth on these matters. It's important that we cooperate.

You mentioned earlier an aboriginal and first nations issue, and this ties in with what you just said about the demographic shift. The youngest population and the fastest growing population is our aboriginal and first nations population—400,000 young aboriginals will be entering the workforce in the next 10 years. What does that kind of demographic shift mean potentially on the economic horizon for Canada, both if we get it right and if we don't get it right?

The Chair: Could you give just a brief response?

Mr. Mark Carney: It is extremely important from a social perspective, but also from an economic perspective, that this segment of our population is as fully integrated into the labour force as they wish to be. If not, we will have lower growth and poorer outcomes, not just for them but for the country as a whole.

The Chair: Thank you.

Thank you, Mr. Brison.

I'm just going to wrap up with a few questions. I know time marches on, and I know colleagues have many more questions.

Perhaps in April we can have you two gentlemen for four hours, a lengthier session.

I have a few questions.

First of all, Governor Carney, in past MPRs you have always mentioned the U.S., Europe, and China. In this one you mentioned Japan. I don't know if you want to make any specific comments with respect to Japan, especially with respect to their exchange rate commitment.

Mr. Mark Carney: Thank you. That's a very important question.

Since our last MPR, there has been a major shift in the policy stance in Japan. There's been a fiscal expansion of a little more than two percentage points, and they have moved to a 2% inflation target. The monetary policy framework previously had a less than 2% inflation target. There has been some concern that, associated with those major, very positive developments in macro policy, Japanese authorities were targeting a certain level of the exchange rate. There have been discussions at the G-7 about this. I'm sure there will be discussions this weekend at the G-20. A statement has been released, which I referenced earlier, based on those discussions, and the crucial point that we make here in Canada—which the Japanese authorities have agreed to acknowledge—is that monetary policy is focused on domestic outcomes. So if you're focusing on the 2% inflation target, you're targeting that domestic outcome, not the exchange rate.

That said, monetary policy has consequences for the exchange rate, all other things being equal, and if monetary policy is looser and more accommodating than it was previously, as it will be in Japan, as it is in Japan, given that they have raised the target for inflation materially, that will have consequences for the exchange rate. But the important thing is to stay focused on the medium term. That's why, because of those major policy changes and because Japan is still the third-largest economy in the world, we highlighted more detail.

The Chair: I appreciate that.

The second item I want to touch on is household debt. It's an issue you have raised constantly, certainly at this committee. The linkage between, obviously, the overnight target rate.... The prime lending rate is somewhat linked to the overnight target rate. It's more obviously long-term than the overnight rate is. But with respect to generational lessons that are being learned, if you look at our grandparents' generation, who lived through the Great Depression, they certainly learned a lesson about debt. My parents paying off mortgages at double-digit rates was certainly a lesson learned.

If you're 25 to 30 years old today, you've experienced very low rates with respect to lines of credit and with respect to mortgages. It's hard not to learn that generational lesson now. As I mentioned, there's a relationship—it's not an exact relationship—between the rates that the bank sets and the rates that they get from their own financial institutions. But to what extent has keeping the overnight rate low had an impact with respect to household debt?

Mr. Mark Carney: Without question, it has supported the growth of household debt. Authorities, including the federal government, this Parliament, in terms of budgets, and the Bank of Canada had to make a judgment on how to support this economy, given the collapse of external demand for Canadian goods, and the judgment was to provide stimulus. With that came risks. One of the risks over time is that there will be a buildup in household debt, and we're faced with options. The government, OSFI, the Bank of Canada, and CMHC are faced with options regarding whether the best weapon to address that risk is the interest rate, whether we should deviate from our inflation target, or whether we should use other mechanisms to attack the problem more directly and ensure that there is appropriate borrowing. We're not against all borrowing. There are still going to be young families starting out who want to buy a house, and that's right; that's appropriate. There are people investing for starting a business. That's absolutely essential.

It's that generational risk point, to use your term, that we're concerned about: people taking on debt that throughout the life of the mortgage they won't be able to support as the economy and interest rates return to a more normal setting.

• (1015)

The Chair: I have about 40 seconds here.

I wanted to ask if you wanted to comment before the committee here on any role you may play with respect to the transition to the next governor.

Mr. Mark Carney: Commenting on that, my commitment to the board, to this committee, and to Canadians is to ensure that there is a seamless transition to the next governor. There is an independent committee of the board that is running a process. The intention is to reach a conclusion. They appoint the individual and it's approved by the federal cabinet. So there's a sort of two-key system there, as it was for all governors, including myself. It's appropriate.

My intention is to serve to June 1. The ideal, obviously, is a short transition, not too long, but a short overlap to assist that individual in taking charge. I'm highly confident that the institution will be well served by the next governor, whoever he or she is.

The Chair: My last troublesome question, because I know you're an Edmonton Oilers fan: when you move to England, are you going to cheer for ManU or Chelsea?

Mr. Mark Carney: I am an Everton supporter, which has a long history. I have some cousins in Liverpool, so I supported Everton. It's been more enjoyable being an Edmonton Oilers supporter than it has been being an Everton supporter of late, but the Oilers are coming back strong this year, and let's hope the Toffees.... Well, Everton is doing okay.

The Chair: Edmonton is doing very well.

On behalf of all committee members, thank you for being here, both of you. We look forward to seeing you back here in April with the next monetary policy report.

This meeting is adjourned.

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